1 9 9 8 ANNUAL REPORT

BONAVISTA PETROLEUM LTD.

PROFITABILITY

CORPORATE PROFILE

Bonavista Petroleum Ltd. is a Calgary, Alberta-based emerging junior oil and natural gas exploration, development and production company actively expanding its reserve and production base in Western Canada. In November 1997, Bonavista appointed a new management team with a mandate to improve overall performance, expand the Company's asset base and strengthen its financial flexibility and health. Bonavista's corporate objectives are to demonstrate sustainable per share growth in production, reserves, cash flow, earnings and asset value for its shareholders. Bonavista is listed on The Toronto Stock Exchange under the symbol "BNP".

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NOTICE OF ANNUAL GENERAL MEETING

The Annual General Meeting of the Shareholders of Bonavista will be held at 3:00 PM on Thursday, May 27, 1999, in the McMurray Room of the Calgary Petroleum Club located at 319 - 5th Avenue SW, Calgary, Alberta. Shareholders who are unable to attend this meeting are requested to complete and return their proxies to the CIBC Mellon Trust Company at their earliest convenience.

CORPORATE HIGHLIGHTS

DECEMBER 31,	1998	1997	% CHANGE
FINANCIAL			
(thousands except per share amounts)			
Production revenue	**$ 26,857**	$ 13,310	102%
Cash flow from operations	**15,442**	5,725	170%
Per share - basic	**0.72**	0.53	36%
Per share - fully diluted	**0.61**	0.49	25%
Net income (loss)	**4,616**	(158)	3,022%
Per share - basic	**0.22**	(0.01)	2,300%
Per share - fully diluted	**0.20**	(0.01)	2,100%
Working capital deficiency	**2,143**	1,167	84%
Total assets	**97,700**	48,379	102%
Long-term debt	**33,835**	2,990	1,032%
Shareholders' equity	**53,306**	39,897	34%
Net capital expenditures	**55,995**	33,233	68%
Common shares outstanding			
Year end			
Basic	**22,459**	21,113	6%
Fully diluted	**27,674**	25,849	7%
OPERATING			
Production			
Natural gas (mcf/day)	**30,998**	12,868	141%
Oil and liquids (bbls/day)	**642**	547	17%
Oil equivalent (boe/day)	**3,742**	1,834	104%
Product prices			
Natural gas ($/mcf)	**2.03**	1.81	12%
Oil and liquids ($/bbl)	**16.76**	24.09	(30%)
Oil equivalent ($/boe)	**19.66**	19.88	(1%)
Cash flow netback ($/boe)	**11.30**	8.55	32%
Operating expenses ($/boe)	**3.76**	4.92	(24%)
General and administrative expenses ($/boe)	**0.49**	2.37	(79%)
Undeveloped land (acres)			
Gross	**337,024**	116,029	190%
Net	**244,258**	64,820	277%
Average working interest	**72%**	56%	16%
Proven and probable reserves			
Natural gas (bcf)	**121.7**	46.9	159%
Oil and liquids (mbbls)	**1,789**	1,772	1%
Oil equivalent (mboe)	**13,959**	6,459	116%
Finding and on-stream costs ($/boe)			
Proven	**7.04**	9.31	(24%)
Proven and probable	**6.31**	6.65	(5%)
Recycle ratio			
Proven	**1.6**	0.9	77%
Proven and probable	**1.8**	1.3	38%

profit: *a) financial gain resulting from the use of capital in a transaction; b) the ratio of such gain to the amount of capital invested; and c) advantage, benefit, gain.*

profit*ability*

ability: *a) power of capacity to act physically, mentally, legally, morally, financially; and b) competence in an activity or occupation.*

PROFITABILITY THROUGH:

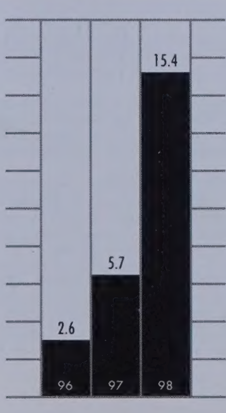
FINANCIAL RESULTS • CASH FLOW OF $15.4 MILLION OR $0.72 PER SHARE • CASH FLOW PER BOE UP 32 PERCENT TO $11.30, DESPITE REVENUE PER BOE REMAINING FLAT • NET INCOME OF $4.6 MILLION OR $0.22 PER SHARE • RECYCLE RATIO OF 1.8 TO 1 ON A PROVEN PLUS PROBABLE RESERVES BASIS AND 1.6 TO 1 ON A PROVEN RESERVES BASIS • MAINTAINED FINANCIAL FLEXIBILITY WITH YEAR END DEBT TO RUNNING CASH FLOW OF 1.4 TO 1 • EXPANDED BONAVISTA'S BANK FACILITY FROM $20 MILLION TO $61 MILLION.

ACHIEVING OUR 1998 TARGETS:

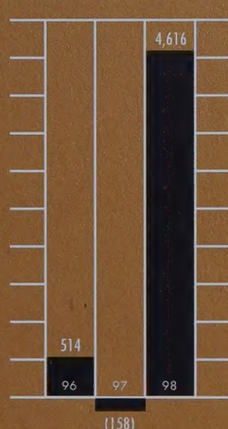
	ACTUAL	INITIAL 1998 TARGET
CASH FLOW ($millions)	$15.4	$14.4
CASH FLOW PER SHARE	$0.72	$0.68
DEBT TO RUNNING CASH FLOW RATIO	1.4:1	LESS THAN 2.0:1

1999 TARGETS:

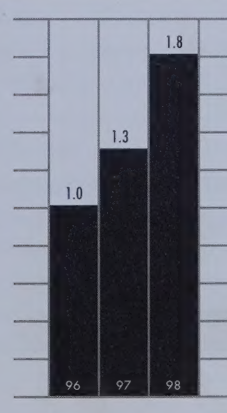
- Cash flow of $32 million or $1.33 per share (basic)
- Retain financial flexibility with debt less than two times cash flow



CASH FLOW
($ millions)



NET INCOME
($ thousands)



RECYCLE RATIO
(cash flow netback/finding and on-stream costs)

MESSAGE TO SHAREHOLDERS

The goal of Bonavista's Board of Directors and management team is to build a strong foundation for long-term profitable growth. A publicly traded company holds the capital investment of its shareholders in trust and assumes an underlying commitment to build value for those shareholders. Although this sentiment is echoed by virtually every publicly-traded company, Bonavista's Board and management team consider this to be their governing principle.

THE theme of this year's annual report is profit*ability*. Profit is a key benchmark of shareholder value. For years, the oil and natural gas industry has focused on cash flow and production growth as the key measures of value creation. Through the recent cycle many companies were growing production and cash flow quickly, but failed to grow profitably. Consequently, we believe investors are now taking a closer look at the principle of bottom-line profit. However, profit or net income are not the only measurement of shareholder value. Bonavista constantly monitors many benchmarks such as recycle ratio, reserve replacement ratio, cash flow per share, operating and corporate overhead, and finding and on-stream costs. Still, the ability to generate a profit, and to grow profit year-over-year, is an indicator that a company is in control of its growth and understands the economic environment of its business.

Profitability is at the heart of the business plan that Bonavista established in November 1997. At that time, as the new management team initiated this plan, we were determined to build a solid foundation from which to grow our business profitably in future years. During late 1997 and in 1998 many of the cornerstones of this foundation were put in place, which strongly positioned Bonavista to report record levels of growth in reserves, production, cash flow and net

income for 1998. Although a portion of any oil and natural gas producer's successes are linked to external factors, the ability to achieve improved year-over-year results depends largely on hard work, focus, technical expertise and management control. Bonavista's management team is resolutely committed to continuing this above-average performance by achieving the following corporate goals:

- Maximize value of existing assets;
- Invest in new opportunities that create value;
- Procure and retain qualified and experienced people;
- Create and preserve operational strength and dominance;
- Maintain financial flexibility; and
- Improve profitability.

The changes we have implemented to date have helped transform Bonavista into a dynamic junior oil and natural gas producer. This is reflected in our solid asset base, which we expanded considerably in 1998 through the investment of $56 million in exploration, development and acquisition opportunities in our core regions.

1998 ACHIEVEMENTS

The 1998 calendar year represents the first full-year results since Bonavista's new management team began a major restructuring of the Company's operations in November 1997. The team at Bonavista is pleased to report to our shareholders that in 1998 we met or exceeded all of the objectives set out at the beginning of the year. This strongly positions us for continued long-term growth and profitability. Some of the key accomplishments in 1998 were:

- **Reduced controllable costs –** We successfully improved Bonavista's overall cost structure. This took a tremendous effort by every employee to focus on those direct expenses which could be controlled. This effort resulted in lower operating, general and administrative, interest and finding and on-stream costs on a per boe basis. We reduced these four key cost components of our business by 24 percent, 79 percent, 16 percent and 5 percent, respectively. In 1999, Bonavista will continue to strive for further efficiencies in all areas of controllable costs.

- **Improved return on investment and profitability –** Lower costs and a significant weighting to natural gas combined to provide a corporate cash flow netback of $11.30 per boe, one of the highest reported in the industry in 1998. This high netback, compared to a relatively low finding and on-stream cost resulted in a 1.8 to 1 recycle ratio which is top-quartile performance of return on investment in the industry. Bottom-line profitability also improved dramatically from a small loss in 1997 to net income of $4.6 million, or $0.20 per share in 1998.

- **Increased undeveloped land base –** Commensurate with increasing production, cash flow and net income levels, we succeeded in significantly enhancing our undeveloped land position. At the end of 1998, Bonavista owned 244,258 net acres of undeveloped land, with 96 percent lying within our three core regions of activity. This expanded land base provides Bonavista with a solid prospect drilling inventory for 1999 and future years.

- **Added and expanded core regions –** Virtually all of our reserves and production increases in 1998 were derived from the two core areas described in last year's annual report – namely the Northwestern Region (formerly Dixonville) and the Eastern Region (formerly

Oyen) and a new core area, the Southern Region near the city of Lethbridge, which was established in the fourth quarter of 1998. In the Northwestern Region, an active drilling and acquisition program led to higher exit production rates of 3,000 boe per day, up from 810 boe per day in 1997. Similarly, in the Eastern Region exit production rates increased to 850 boe per day, up from 630 boe per day at year end 1997. Our goal of adding a third area of focus in 1998 was achieved with two acquisitions in the Lethbridge area. This natural gas prone region came with 6.5 mmcf per day of natural gas production, high working interests and operatorship in three natural gas plants, 84,000 net acres of undeveloped land and in excess of 2,000 miles of seismic data. The region fits extremely well with Bonavista's core region criteria and will receive substantial attention and effort in 1999 and beyond.

STRATEGIES FOR PROFITABLE GROWTH

Our 1998 success was the result of a disciplined and proven growth strategy implemented in late 1997, more specifically involving:

- **Building a qualified and experienced team –** Unquestionably, the fundamental resource of a successful company is its people. A dedicated and determined team, given the proper tools and working environment, will result in top performance in any industry. We pride ourselves on being able to attract and retain high calibre employees. To date, a qualified team of 25 people has been assembled, all of whom are shareholders in Bonavista, and all of whom are dedicated to improving our performance.

- **Continuing operational strength and dominance –** By having secured a position of dominance in our core regions through strong land holdings and ownership of facilities and gathering systems, we control the timing and cost of exploration and development activities as well as the speed of tying-in production. As a result of strengthening our position in our core regions in 1998, we currently have an average working interest in our production base of 92 percent, operate approximately 95 percent of our production and operated 100 percent of the 41 wells drilled in 1998. By owning and operating a large number of facilities and infrastructure in our core regions, we ensure rapid conversion of undeveloped land and non-producing reserves to producing reserves and maximize the value of Bonavista's existing and future assets.

- **Enforcing strict cost control –** As in 1998, we will continue to actively reduce costs by maintaining control of our asset base and by ensuring spending efficiency is one of our top priorities. We strive to achieve the highest possible re-investment efficiency, and to that end continuously monitor all aspects of our spending including finding and on-stream, operating, general and administrative, and interest costs in order to maximize both our use of capital and the return to our shareholders. We believe that Bonavista's long-term profitability depends on our ability to be one of the lowest cost producers and finders in our industry.

- **Maintaining financial flexibility –** Financial flexibility is paramount in the capital intensive oil and natural gas business. We believe that by investing our shareholders' capital wisely and quickly converting the investment into cash flow, we can maintain a healthy balance sheet with a debt to running cash flow ratio less than two to one and continue to report significant growth results.

1999 OUTLOOK

The ongoing success of Bonavista's strategies is evident in our first quarter 1999 results. We drilled 31 wells in the first three months, resulting in 23 natural gas wells. During the remainder of the year, we plan to drill an additional 40 wells in our three core regions and to continue to pursue small complementary property acquisitions. Accordingly, Bonavista has budgeted a capital program of $65 million for 1999, including $15 million for property acquisitions. Our 1999 budget is based upon $2.40 per mcf for natural gas and $13 US per bbl for West Texas Intermediate oil, which will support forecasted production levels of 55 mmcf per day of natural gas and 800 bbls per day of oil and liquids. This program is expected to generate cash flow in excess of $32 million or $1.33 per share (basic). Production volumes at the end of the first quarter were 52 mmcf per day of natural gas and 700 bbls per day of oil and liquids or 5,900 boe per day, providing an excellent foundation for accomplishing our 1999 targets.

Crude oil and natural gas prices remain volatile and therefore require considerable attention when planning capital programs. Recognizing the potential for industry conditions to change quickly, Bonavista remains flexible to either accelerate or throttle-back our capital program.

In closing, Bonavista is strategically positioned, both operationally and financially, heading into the turn of the century. Our proven growth strategy, our focused and dedicated staff, and the tremendous support from our existing shareholders will allow us to continue to take advantage of ongoing industry consolidation and keep our profitable growth perpetuating into the future. We wish to thank all of our shareholders for their support in the implementation of this new business plan, our Board of Directors for their guidance and our employees for their determined efforts.

Keith A. MacPhail
President and Chief Executive Officer

Ronald J. Poelzer
Vice President and Chief Financial Officer
April 9, 1999

OPERATIONS AND EXPLORATION REVIEW

Bonavista's major properties and activities are concentrated within three core regions in the province of Alberta. As a result of our strategic positioning in each region, Bonavista has significant opportunities for expanding its exploration and development programs and continuing with its synergistic property acquisitions program. These core regions constitute a well balanced portfolio of Company-operated producing properties, and exploration and development prospects with significant upside potential. The three core operating regions are: Northwestern Region, Eastern Region and Southern Region. Bonavista also has smaller operations in Southeast Saskatchewan.

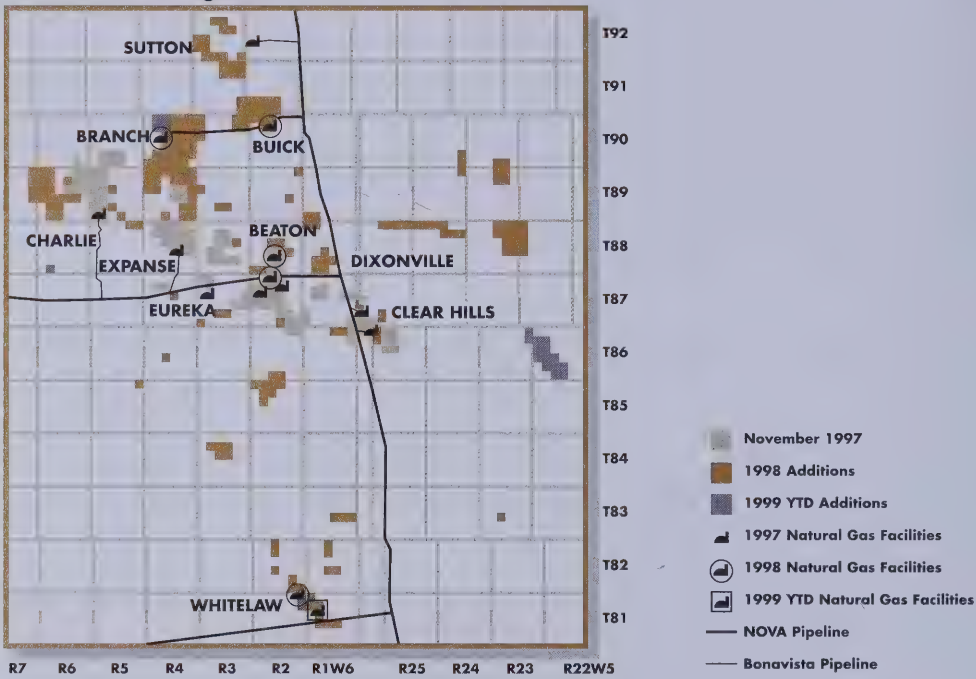
DURING 1998, Bonavista's asset base grew significantly through the investment of $56 million in exploration, development and acquisitions in its three core operating regions. This active exploration and development program resulted in 41 (38.8 net) wells being drilled, primarily in our Northwestern and Eastern core regions, with an overall success rate of 76 percent. Bonavista operated all of these wells, and had a 100 percent working interest in all but five wells. To accommodate the new production from our drilling success, Bonavista installed seven new compressor facilities in our Northwestern and Eastern core regions. Operatorship and high working interest ownership remain essential components of our business plan, and help ensure maximum benefit to our shareholders and control of the Company's future growth. In addition to our 1998 exploration and development program, we consummated 14 complementary acquisitions in our existing core regions and acquired two joint venture partners' interests in the Lethbridge area of southern Alberta, providing the foundation for Bonavista's third core region.

All of Bonavista's core regions have extensive company-operated gathering and processing facilities, as well as substantial contiguous undeveloped acreage. The core regions will be the primary areas of focus for the $65 million capital program in 1999. This record capital budget will be comprised of $50 million for exploration and development and $15 million targeted for smaller-sized acquisitions within existing Company core regions. Bonavista's capital expenditures are forecasted to result in growth of over 65 percent in the average daily production rate to approximately 6,300 boe per day from 3,742 boe per day in 1998, and an increase of 109 percent in cash flow to $32.0 million in 1999 from $15.4 million in 1998.

THE NORTHWESTERN REGION is Bonavista's largest core area and is characterized by prolific, high deliverability natural gas reserves in multiple, shallow to medium depth horizons. The region is located near the town of Peace River, Alberta and is natural gas prone, with primary production originating from the Cretaceous, Triassic and Devonian formations. Bonavista is currently producing 29 mmcf per day of natural gas and 400 bbls per day of oil and liquids in the area, 98 percent of which is operated. This has increased from the average 18.3 mmcf per day and 248 bbls per day in 1998 and from 7.5 mmcf per day and 57 bbls per day at year end 1997. We currently have an average working interest of 92 percent in our undeveloped land in the Northwestern Region. Bonavista also owns and operates 14 facilities in this region. These 14 facilities have a combined processing capacity of 50 mmcf per day and an average working interest of 82 percent. The Northwestern Region includes several Bonavista-operated properties that collectively accounted for:

- 64 percent of 1998 capital expenditures;
- 56 per cent of 1998 production volumes;
- 56 per cent of total year end 1998 proven and probable reserves; and
- 50 per cent of undeveloped land holdings at December 31, 1998.

Northwestern Region



During 1998, Bonavista conducted a very active exploration, development and acquisition program in its Northwestern Region totalling $35 million in capital expenditures. The program resulted in 31 wells (29 net), four new compressors, an increase of 85,865 net acres in undeveloped land and the purchase of 12 properties in this core region.

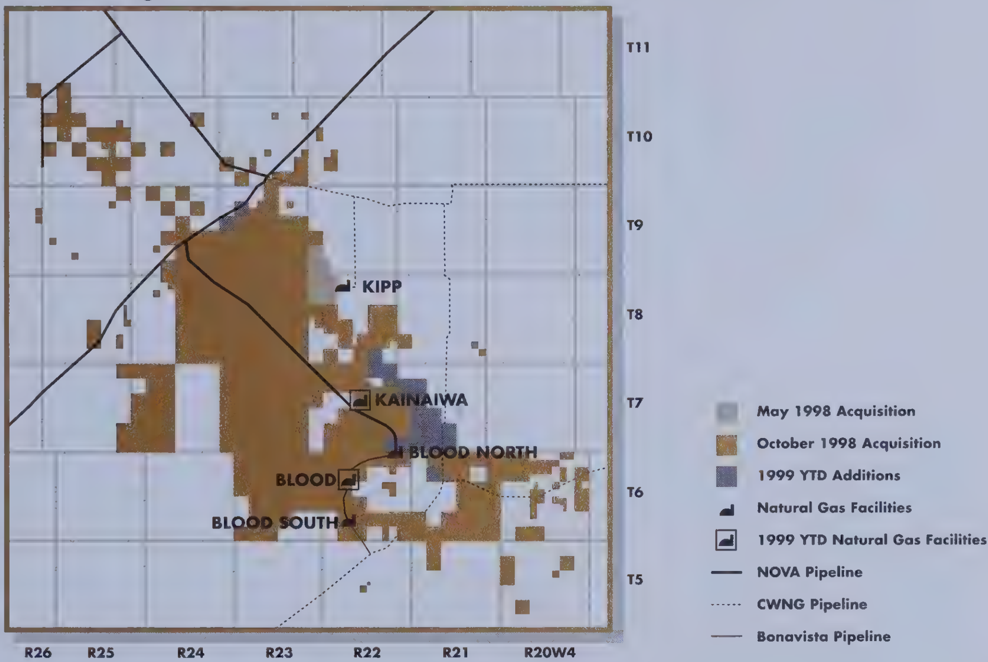
We plan to spend $33 million of our capital program in this area in 1999, including drilling 42 (40 net) wells, recompleting up to 12 wells and installing four compressors. In the first quarter of 1999, Bonavista had an active drilling program in the Northwestern Region, including 24 (24 net) wells resulting in 17 (17 net) natural gas wells for a success rate of 71 percent. When these wells are tied into Bonavista-operated facilities, the combined production increase will be 8.5 mmcf per day. In addition, Bonavista completed two separate acquisitions in the region in the first quarter of 1999, acquiring 1.1 mmcf per day of natural gas production, and approximately 3,000 net acres of undeveloped land. The total undeveloped acreage in the Northwestern Region is now approximately 129,000 net acres.

	November 1997	Annual 1998	Current
Natural gas production (mmcf/day)	7.5	18.3	29.0
Oil and liquids production (bbls/day)	42	248	400
Undeveloped land (net acres)	35,840	121,705	129,000

1998 drilling – 31 wells

1999 drilling plans - 42 wells

Southern Region



BONAVISTA'S NEWEST CORE REGION, THE SOUTHERN REGION, was established through two acquisitions in May and October 1998. These assets are located near the city of Lethbridge in Southern Alberta and make up Bonavista's second largest core region. Current production is from medium depth, multi-zone horizons, primarily from the Bow Island and Basal Colorado formations, with deeper exploration potential in the Mississippian and Devonian formations. Bonavista has an average working interest of 75 percent in current production in this region, operates three natural gas plants with processing capacity of 27 mmcf per day, owns 88,000 net acres of undeveloped land and over 2,000 miles of seismic data. Bonavista also has the opportunity to earn an additional 55,000 net acres of land through special exploration permits and leases with the Blood First Nations.

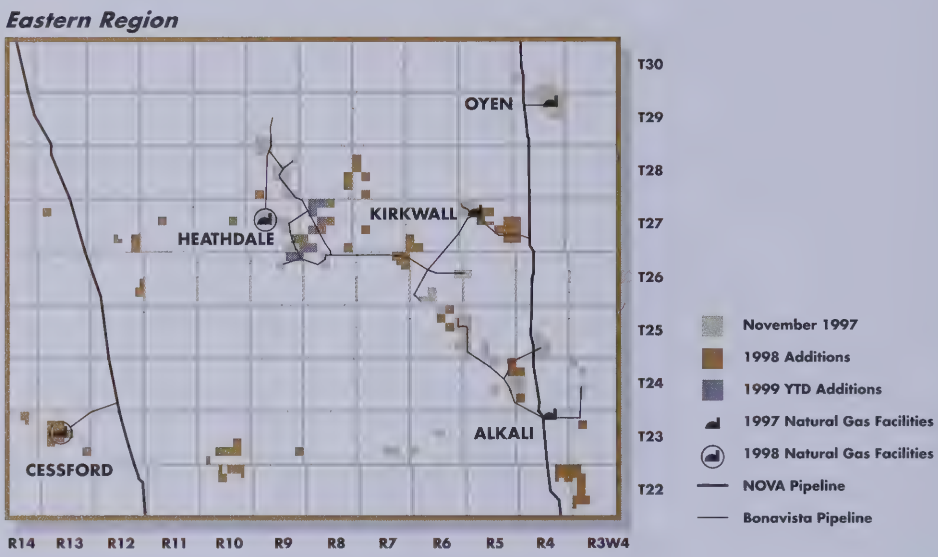
The Southern Region properties, all of which are operated by Bonavista, collectively accounted for:

- 22 percent of 1998 capital expenditures;
- 23 percent of 1998 production volumes;
- 17 percent of total year end 1998 proven and probable reserves; and
- 34 percent of undeveloped land holdings at December 31, 1998.

As a result of Bonavista's first quarter 1999 capital program, current production from the Southern Region is 11.5 mmcf per day of natural gas, up from 6.5 mmcf per day at year end 1998. Total exploration and development expenditures of $12 million are planned for the region in 1999, including drilling 13 (10.5 net) wells, tie-in of up to 12 previously drilled wells and installing two compressor stations. These projects will continue to expand natural gas production in the area to about 14 mmcf per day by year end 1999.

	May 1998	Annual 1998	Current
Natural gas production (mmcf/day)	0.9	3.2	11.5
Undeveloped land (net acres)	960	83,927	88,000

1999 drilling plans - 13 wells



BONAVISTA'S EASTERN REGION is located directly east of the city of Calgary, Alberta and encompasses an area up to the Saskatchewan/Alberta provincial border. The region includes the Oyen area, Cessford, Rockyford and Verger core properties and is characterized by production from shallow, multi-zone horizons, primarily from the Viking, Glauconite and Detrital zones. We have an average working interest of 78 percent in this area and operate five natural gas plants with processing capacity of 23 mmcf per day, net to Bonavista. Bonavista has ownership interests in various gathering systems and pipelines, which span in excess of 100 miles in this area, and allows Bonavista to bring new reserves on-stream quickly and cost-effectively. During 1998, Bonavista invested $5 million in the Eastern Region, which included drilling 8 (7.8 net) wells, installing one compressor and increasing our undeveloped land position by 22,499 net acres. As a result of tying-in three recently drilled wells, current production from this area averages 9.5 mmcf per day of natural gas and 40 bbls per day of oil and liquids, compared to an average 8.2 mmcf per day and 42 bbls per day of oil and liquids in 1998. The Eastern Region properties, all of which Bonavista operates, accounted for:

- 10 percent of 1998 capital expenditures;
- 9 percent of 1998 production volumes;
- 17 percent of total year end 1998 proven and probable reserves; and
- 12 percent of undeveloped land holdings at December 31, 1998.

In 1999, Bonavista plans to invest $5 million of capital expenditures in the Eastern Region, including drilling 18 (13.4 net) wells and recompleting three additional wells. These projects are expected to expand production to approximately 12 mmcf per day of natural gas and 40 bbls per day of oil and liquids by year end 1999.

	November 1997	Annual 1998	Current
Natural gas production (mmcf/day)	4.8	8.2	9.5
Oil and liquids production (bbls/day)	21	42	40
Undeveloped land (net acres)	6,080	28,579	32,000

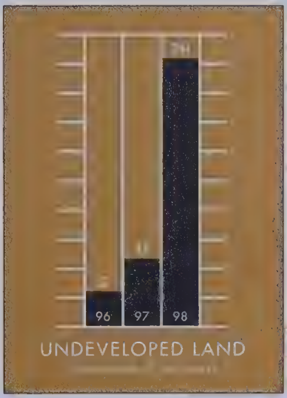
1998 drilling – 8 wells

1999 drilling plans - 18 wells

BONAVISTA'S SOUTHEAST SASKATCHEWAN area includes the Creelman, Frys and Hoffer properties, which currently produce approximately 240 bbls per day of light and medium gravity crude oil. The primary zones of production are from the Frobisher, Tilston and Ratcliff zones within the Mississippian formation. Bonavista holds an average working interest of 75 percent in this area, which includes operated central batteries and water disposal facilities to accommodate production. In 1998, Bonavista invested minimal capital in southeast Saskatchewan due to the low crude oil prices. Depending on crude oil prices in 1999, Bonavista may spend up to $2 million to drill three (2.8 net) horizontal wells, which should add production of 200 bbls per day.

UNDEVELOPED LAND

Bonavista recognizes the importance of expanding its undeveloped land base in order to maintain an active inventory of drilling prospects. To this end, the Company greatly expanded its land base in 1998 through participation in Crown land sales, industry farm-ins and undeveloped land included with producing properties acquisitions. In 1998, Bonavista increased its land base by 277 percent to 244,258 net acres. Of this increase, 60,640 acres were acquired at Provincial Crown land sales at an average cost of $49 per acre. Almost 96 percent of the undeveloped land at December 31, 1998 is contained within our three core regions, while the average working interest has also increased from 56 percent in 1997 to 72 percent in 1998. Bonavista has amassed over 150 drilling locations on this land base and expects to further increase both its undeveloped acreage and the number of drilling prospects in 1999. Total land expenditures on Crown land purchases is anticipated to be $5 million in 1999 versus $3 million in 1998. The following table summarizes Bonavista's inventory of undeveloped acreage on a year-to-year comparative basis and on a core region basis:



Year end

December 31,	1998	1997	% Change
Gross acres	**337,024**	116,029	190%
Net acres	**244,258**	64,820	277%
Average working interest	**72%**	56%	16%
Estimated value ($ millions)	**$ 15.8**	$ 3.8	316%

Regional breakdown

	Gross (acres)	Net (acres)	Net (% of total)	Average Working Interest
Northwestern region	132,030	121,705	50%	92%
Southern region	113,351	83,927	34%	74%
Eastern region	40,448	28,579	12%	71%
Other areas	51,195	10,047	4%	20%
TOTAL UNDEVELOPED LAND	**337,024**	**244,258**	**100%**	**72%**

SEISMIC

Bonavista utilizes extensive geophysics, both two and three-dimensional, to delineate geological features such as pools or trends to reduce the risks of its drilling prospects. In 1998, Bonavista invested approximately $2 million in seismic related activity. Approximately $3.5 million of the 1999 capital program has been allocated to acquiring additional seismic data which will supplement our existing seismic data base of over 5,000 miles.

PETROLEUM RESERVES

Bonavista's petroleum reserves have been evaluated as at January 1, 1999, by McDaniel & Associates Consultants Ltd. in their report dated February 26, 1999. The following table summarizes the key information of Bonavista's petroleum reserves:

	NATURAL GAS		OIL AND LIQUIDS		PRESENT VALUE OF CASH FLOW BEFORE INCOME TAXES - DISCOUNTED AT [3]		
	Gross [1] (mmcf)	Net [1] (mmcf)	Gross [1] (mbbls)	Net [1] (mbbls)	0%	10% (000's)	15%
Proven producing	77,754	62,218	1,293	1,115	$ 137,299	$ 86,014	$ 73,946
Proven non-producing	21,776	16,635	41	35	33,265	19,772	16,226
ARTC	–	–	–	–	10,955	6,771	5,710
Total proven	99,530	78,853	1,334	1,150	181,519	112,557	95,882
Probable (risked) [2]	22,166	17,327	455	379	20,106	9,489	7,303
ARTC [2]	–	–	–	–	694	219	136
TOTAL	121,696	96,180	1,789	1,529	$202,319	$122,265	$103,321

[1] "Gross" reserves are the total remaining recoverable reserves owned by Bonavista before deduction of royalties. "Net" reserves are defined as those accruing to Bonavista after all interests owned by others, including Crown and freehold royalties have been deducted.

[2] Value of probable reserves are reduced by 50 percent to account for risk.

[3] The pricing forecast used in determining the value of cash flow is based on the January 1, 1999, McDaniel & Associates Consultants Ltd. price forecast which includes an oil price for 1999 of $14.50 US per bbl WTI or $20.60 CDN per bbl at Edmonton and $2.30 per mcf for an average Alberta natural gas field price.

Reconciliation of reserves

	NATURAL GAS (mmcf)			OIL AND LIQUIDS (mbbls)		
	Proven	Probable	Total	Proven	Probable	Total
Reserves, January 1, 1997	8,597	870	9,467	946	239	1,185
Net additions	34,129	9,764	43,893	489	428	917
Revisions	(2,502)	710	(1,792)	(79)	(51)	(130)
Production	(4,697)	–	(4,697)	(200)	–	(200)
Reserves, January 1, 1998	35,527	11,344	46,871	1,156	616	1,772
Net additions	72,566	12,746	85,312	339	11	350
Revisions	2,751	(1,924)	827	73	(172)	(99)
Production	(11,314)	–	(11,314)	(234)	–	(234)
RESERVES, JANUARY 1, 1999	99,530	22,166	121,696	1,334	455	1,789

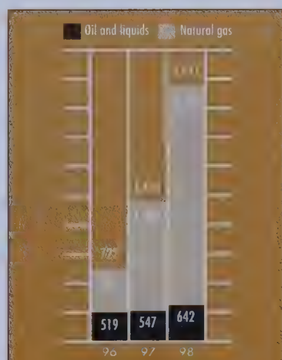
Efficiency Ratios

The following outlines three performance measurements which depict the overall efficiency of capital invested during the year: Finding and on-stream costs, Recycle ratio and Reserve replacement ratio. In 1998, Bonavista posted strong results in all of these performance measurements, as well as improving performance when comparing to 1997 results.

	1998	1997	% Change
Net capital expenditures (000's)	**$ 55,995**	$ 33,233	68%
Reserve additions (mboe)			
Proven	**7,943.7**	3,572.7	122%
Proven and probable	**8,864.9**	4,997.1	77%
Finding and on-stream costs ($/boe)			
Proven	**7.04**	9.31	(24%)
Proven and probable	**6.31**	6.65	(5%)
Cash flow netback ($/boe)	**11.30**	8.55	32%
Recycle ratio (cash flow netback/finding and on-stream costs)			
Proven	**1.6**	0.9	77%
Proven and probable	**1.8**	1.3	38%
Reserve replacement ratio (reserve additions/annual production)			
Proven	**5.8**	5.3	9%
Proven and probable	**6.6**	7.3	(10%)

PRODUCTION

Bonavista's average daily production increased 104 percent to 3,742 boe per day in 1998, from 1,834 boe per day in 1997. Natural gas production rose 144 percent to 31.0 mmcf per day in 1998 from 12.9 mmcf per day in 1997, while oil and liquids production increased 17 percent to 642 bbls per day in 1998 from 547 bbls per day in 1997. Entering the second quarter of 1999, production volumes are continuing to increase to approximately 5,900 boe per day, consisting of 52 mmcf per day of natural gas and 700 bbls per day of oil and liquids.



PRODUCTION
(boe/day)

Production by region

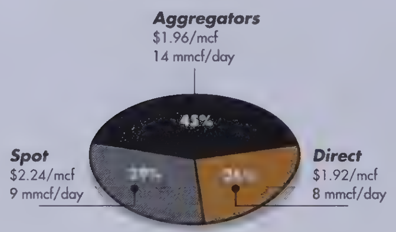
	1998 AVERAGE PRODUCTION			1997 AVERAGE PRODUCTION		
	Natural Gas (mmcf/day)	**Oil and Liquids (bbls/day)**	**Total (boe/day)**	Natural Gas (mmcf/day)	Oil and Liquids (bbls/day)	Total (boe/day)
Northwestern region	**18.3**	**248**	**2,078**	5.4	82	622
Eastern region	**8.2**	**42**	**862**	6.3	40	670
Southern region	**3.2**	**2**	**322**	–	–	–
Southeast Saskatchewan	**–**	**242**	**242**	–	289	289
Other	**1.3**	**108**	**238**	1.2	136	253
TOTAL PRODUCTION	**31.0**	**642**	**3,742**	12.9	547	1,834

MARKETING

Natural gas

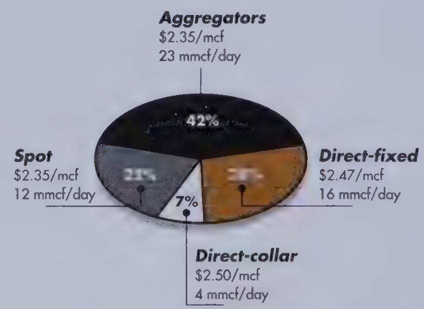
Bonavista's dynamic growth in natural gas sales in 1998 brought the need to develop a strategy to balance the natural gas portfolio, both by market type as well as by term. The ultimate objective is to maintain a diverse natural gas portfolio with a minimum of 25 percent being sold at fixed prices for one year or longer. The remainder of the natural gas sales would be to either aggregators or to direct markets employing short term variable pricing. Implementation of this strategy in 1998 resulted in an average realization price of $2.03 per mcf for Bonavista compared to $1.81 per mcf in 1997. For 1999 the Company has forecasted its natural gas price to average $2.40 per mcf. The respective contract portfolios are comprised of the following:

1998



1998 Average of $2.03/mcf on 31 mmcf/day

1999 F



1999 Average of $2.40/mcf on 55 mmcf/day

Crude oil

The majority of Bonavista's crude oil and liquids production is being sold to Tidal Energy Marketing on a month-to-month spot basis. In 1998, Bonavista's oil and liquids price decreased 30 percent to 16.76 per bbl from 24.09 per bbl in 1997. At this time none of the Company's crude oil has been sold forward. The 1999 budget is based on an average WTI price of $13.00 US per bbl.

MANAGEMENT'S DISCUSSION AND ANALYSIS

OVERVIEW

MANAGEMENT'S DISCUSSION AND ANALYSIS of Bonavista's financial position and results of operations should be read in conjunction with the consolidated financial statements presented in this Annual Report.

The following tables set forth a summary of operations, including netbacks for 1998 compared to 1997, and netbacks on a product basis:

	1998		1997		% Change 1998 -1997	
PRODUCTION	**3,742 boe/day**		1,834 boe/day		104%	
	(000's)	**($/boe)**	(000's)	($/boe)	(total)	(per unit)
Field netback:						
Production revenue	**$ 26,857**	**$19.66**	$ 13,310	$ 19.88	102	1
Royalties	**(5,062)**	**(3.71)**	(2,321)	(3.47)	118	7
Alberta Royalty Tax Credit	**1,387**	**1.02**	659	0.98	110	4
Operating expenses [1]	**(5,145)**	**(3.76)**	(3,293)	(4.92)	56	(24)
FIELD NETBACK	**18,037**	**13.21**	8,355	12.47	116	6
General and administrative expenses	**(661)**	**(0.49)**	(1,585)	(2.37)	(58)	(79)
Financing charges [1]	**(1,731)**	**(1.27)**	(1,018)	(1.51)	70	(16)
Capital taxes	**(203)**	**(0.15)**	(27)	(0.04)	652	275
CASH FLOW NETBACK	**15,442**	**11.30**	5,725	8.55	170	32
Depreciation, depletion and site restoration expenses	**(9,958)**	**(7.29)**	(5,883)	(8.79)	69	17
Deferred income taxes	**(868)**	**(0.64)**	–	–	N/A	N/A
NET INCOME (LOSS)	**$ 4,616**	**$ 3.37**	$ (158)	$ (0.24)	3,022	1,504

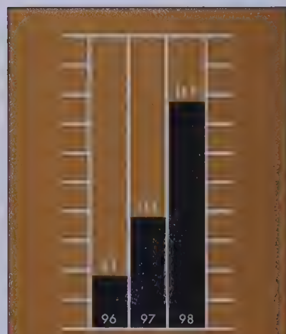
[1] In 1997 certain costs relating to leases on facilities have been reclassified from financing charges to operating expenses for presentation purposes.

Netback by product

	OIL AND LIQUIDS		NATURAL GAS		1998 TOTAL	
1998 PRODUCTION	642 bbls/day		30,998 mcf/day		3,742 boe/day	
	(000's)	**($/bbl)**	**(000's)**	**($/mcf)**	**(000's)**	**($/boe)**
Field netback						
Production revenue	**$ 3,931**	**$ 16.76**	**$ 22,926**	**$ 2.03**	**$ 26,857**	**$ 19.66**
Royalties	**(526)**	**(2.24)**	**(4,536)**	**(0.40)**	**(5,062)**	**(3.71)**
Alberta Royalty Tax Credit	**91**	**0.38**	**1,296**	**0.11**	**1,387**	**1.02**
Operating expenses	**(1,365)**	**(5.83)**	**(3,780)**	**(0.33)**	**(5,145)**	**(3.76)**
FIELD NETBACK	**$ 2,131**	**$ 9.07**	**$ 15,906**	**$ 1.41**	**$ 18,037**	**$ 13.21**

Revenues

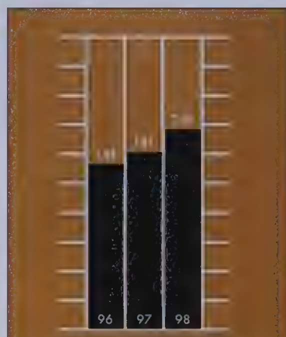
The implementation of Bonavista's 1998 business plan resulted in significantly higher revenues, production and cash flow. Gross revenues for 1998 increased 102 percent to $26.9 million from $13.3 million in 1997. Natural gas revenues rose 170 percent to $22.9 million in 1998 from $8.5 million in 1997. Overall natural gas production for the year increased 141 percent to 31.0 mmcf per day from 12.9 mmcf per day in 1997. At the same time, Bonavista also achieved a 12 percent increase in the average natural gas price to $2.03 per mcf from $1.81 per mcf realized in 1997. Revenues from oil and liquids, however, fell 18 percent in 1998 to $3.9 million versus $4.8 million in 1997, as a result of a 30 percent decline in oil and liquids average price to $16.76 per bbl in 1997 from $24.00 per bbl in 1998. This decrease was partially offset by the 17 percent increase in oil and liquids production to 642 bbls per day from 547 bbls per day in 1997.



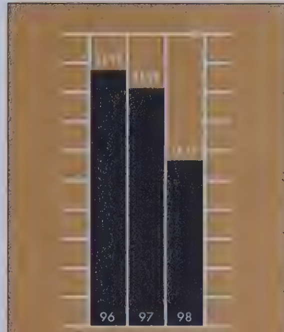
GROSS REVENUE
($ millions)

Royalties

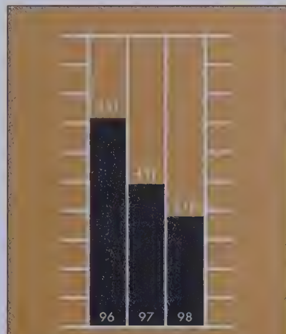
In 1998, royalties increased 118 percent to $5.1 million from $2.3 million in 1997, due to higher gross revenues associated with increased production volumes. The average royalty rate, before ARTC, increased to 19 percent in 1998 from 17 per cent in 1997, as a result of higher natural gas prices in 1998. The increased royalties resulted in a significant increase in ARTC to $1.4 million in 1998 compared to $0.7 million in 1997, as all the production increases were in the province of Alberta. Because Bonavista reached the ARTC maximum and acquired certain ARTC ineligible properties in 1998, the average royalty rate after ARTC increased to 14 percent for 1998 from 13 percent in 1997.



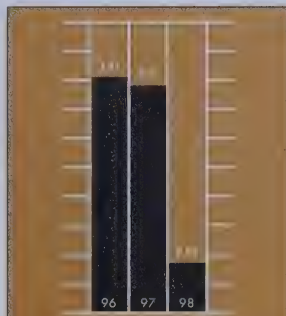
NATURAL GAS PRICING



OIL AND LIQUIDS PRICING



OPERATING EXPENSES



GENERAL AND ADMINISTRATIVE EXPENSES
($/boe)

Operating expenses

Increased production volumes resulted in a 56 percent increase in operating expenses, which totalled $5.1 million in 1998 compared with $3.3 million in 1997. On a per boe basis, operating costs declined 24 percent to $3.76 in 1998 from $4.92 in 1997. This decrease reflects Bonavista's emphasis on reducing per unit operating costs at existing properties and the lower per unit cost of additional natural gas production brought on-stream in 1998.

General and administrative expenses

Net general and administrative expenses declined 58 percent to $0.7 million from the prior year's $1.6 million expense. This decrease was due to the cost controls implemented in November 1997 and due to higher overhead recoveries in 1998 versus 1997, that resulted from operating a much larger capital and operating program without a proportionate increase in corporate infrastructure. On a per boe basis, general and administrative expenses decreased 79 percent to $0.49 per boe in1998 from $2.37 per boe in 1997.

Financing charges

Financing charges increased 70 percent in 1998 to $1.7 million from $1.0 million in 1997, reflecting higher average debt levels associated with the 1998 capital program.

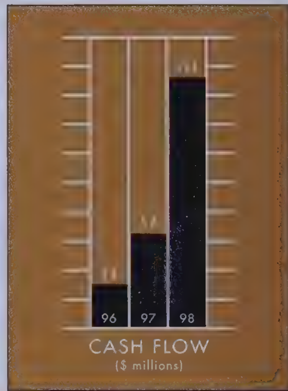
Depreciation, depletion and site restoration expenses

Depreciation, depletion and site restoration expenses rose 69 percent to $10.0 million in 1998 from $5.9 million in 1997, as a direct result of the increased asset base and production volumes. On a per boe basis, the average depreciation, depletion and site restoration rate decreased 17 percent to $7.29 in 1998 from $8.79 in 1997 as a direct result of the lower-cost proven reserve additions in 1998.

Income and other taxes

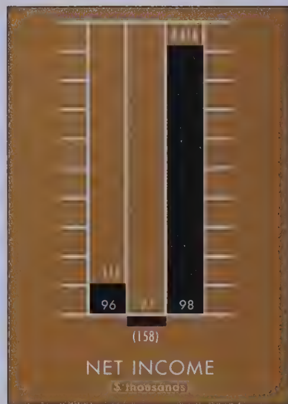
The provision for income and other taxes increased to $1.1 million in 1998 from the previous year's $27,000. This resulted partially from the higher Large Corporation Tax of $203,000 in 1998 versus $27,000 in 1997, based on the significantly increased capital structure of the Company. Bonavista recorded a deferred tax provision of $868,000 in 1998 as a consequence of the profitable turnaround, whereas 1997 required no deferred tax provision.

Cash flow and net income



Bonavista had substantially higher cash flow in 1998 as a result of increased production of oil and gas. Cash flow was 170 percent higher at $15.4 million or $0.72 per share basic, compared to $5.7 million or $0.53 per share in 1997. In addition, cash flow per boe increased 32 percent to $11.30 from $8.55, which was one of the highest cash flow net backs in the industry. Due to a significant increase in cash flow and partially as a result of decreased depreciation, depletion and site restoration expenses on a per unit basis, Bonavista restored net income to $4.6 million, or $0.22 per share, compared to a loss of $158,000 or $0.01 per share in 1997.

Capital expenditures



Bonavista conducted a full-cycle exploration and development capital program in 1998, spending $56 million. During the year, we participated in the drilling of 41 wells (38.8 net), which resulted in an overall success rate of 76 percent. During 1998, Bonavista added 7.9 million boe of proven reserves and 9.0 million boe of proven and probable reserves through drilling and acquisitions, net of revisions and dispositions. With $56 million of net capital expenditures in 1998, the investment cost on 1998 proven additions was $7.04 per boe and $6.31 per boe on a proven plus probable basis. The following table outlines the capital expenditures in 1998 compared to 1997:

	1998 (000's)	1997 (000's)
Land and acquisitions	**$ 30,447**	$ 28,177
Geological and geophysical	**1,985**	1,574
Drilling and completions	**13,796**	1,698
Production equipment and facilities	**9,577**	2,552
Capitalized general and administrative	**–**	114
Other	**205**	81
Total capital expenditures	**56,010**	34,196
Dispositions	**(15)**	(963)
NET CAPITAL EXPENDITURES	**$ 55,995**	$ 33,233

Tax pools

Bonavista had $116,824,000 of tax pools at December 31, 1998. These tax pools will shelter Bonavista's taxable income for several years as well as add flexibility to pursue acquisitions. The following table summarizes the tax pool balances as at December 31, 1998:

	Available Balance (000's)	Maximum Annual Deduction
Canadian Exploration Expense	$ 22,288	100%
Canadian Development Expense	17,227	30%
Canadian Oil & Gas Property Expense	37,011	10%
Undepreciated Capital Cost	38,165	8%-30%
Other	2,133	20%-100%
TOTAL	$ 116,824	

Liquidity and capital resources

Bonavista's 1999 capital expenditures will be approximately $65 million. In anticipation of this 1999 capital program, in December of 1998 Bonavista issued 927,700 flow-through common shares at a price of $8.90 per share for proceeds of $8.3 million. The remaining portion of the capital program will be financed from approximately $32 million of 1999 cash flow, $6.3 million through the exercise of the Special A Warrants and $19 million through the unused portion of the existing bank facility. Bonavista's capital expenditures are primarily discretionary exploration and development activities and acquisitions, with approximately $3 million of non-discretionary capital expenditures in 1999. Bonavista is readily able to adjust its expenditures should opportunities arise. At December 31, 1998, Bonavista's debt to running cash flow ratio was approximately 1.4:1. With the present profile of capital spending and cash flow growth, Bonavista anticipates an exit debt of 1.6 times annualized exit 1999 cash flow.

Bonavista currently has a $61 million revolving demand loan facility that bears interest at prime and is not required to make any principal repayments in 1999. This facility will be expanded as required for capital spending and has been set below Bonavista's current borrowing base. Bonavista settles sales receivables and trade payables in accordance with normal industry practices. Working capital liquidity is maintained through drawing and repaying the bank facilities.

Business Risks

All companies in the Canadian oil and natural gas industry are exposed to a number of business risks, some of which are beyond the control of the company. These can be categorized as operational, financial and regulatory risks.

Operational risks include finding and developing oil and natural gas reserves on an economic basis, reservoir production performance, marketing production, hiring and retaining employees and accessing contract services on a cost effective basis. Bonavista mitigates these risks by employing a team of highly qualified professionals, providing a compensation system that rewards above average performance and by developing strong long-term relationships with contract service providers. The

Company maintains an insurance program consistent with industry practice to protect against destruction of assets, well blowouts, pollution and other business interruptions. We also maintain a geologically diverse, but geographically concentrated, prospect inventory, undertake a large drilling program and use proven technology where appropriate.

Financial risks include commodity prices, interest rates and the Canada/US exchange rate, all of which are largely beyond Bonavista's control. While in the past the Company has used financial instruments, currently there are none in place with respect to these risks. Bonavista's approach to management of these risks is to maintain a prudent level of debt, to enter into certain fixed price physical delivery natural gas contracts, and to use its strong financial position to fund exploration and development activities and acquisitions through fluctuations in these variables.

Bonavista is also subject to various regulatory risks, many of which are beyond our control. We take a proactive approach with respect to environmental and safety matters, such as maintaining an environmental and safety program whereby major facilities are frequently audited. An operational emergency response plan is in place and is in substantial compliance with current environmental legislation.

Year 2000 Issue

Bonavista is undertaking a review of the implications of the year 2000 on all business processes to ensure there will be no adverse impact by the arrival of the new millennium. This review includes an evaluation, in consultation with hardware and software vendors, of potential problems in key operating and information systems. In early 1998, Bonavista completed the conversion of financial and production accounting and land systems. In addition, we are reviewing the impact of the year 2000 issue on field operations, where limited computer applications are currently in use. Overall, we have reviewed the implications of this issue and we believe that the year 2000 issue will not have a material impact on the operation of our business. The costs associated with the implementation of year 2000 systems are being capitalized in accordance with Bonavista's accounting policies and are not material.

MANAGEMENT'S REPORT

THE accompanying consolidated financial statements are the responsibility of management in accordance with accounting principles generally accepted in Canada. Financial information contained elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

Management is responsible for the integrity and objectivity of the financial statements. Where necessary, the financial statements include estimates which are based on management's informed judgments. Management has established systems of internal controls which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. It exercises its responsibilities primarily through the Audit committee, the majority of whom are non-management directors. The Audit Committee has reviewed the consolidated financial statements with management and the auditors and have reported to the Board of Directors who have approved the consolidated financial statements.

KPMG are independent auditors appointed by Bonavista's shareholders. The auditors have considered, for the purposes of determining the nature, timing and extent of their audit procedures, the Company's internal controls and have audited the consolidated financial statements in accordance with generally accepted auditing standards to enable them to express an opinion on the fairness of the financial statements.

Keith A. MacPhail
President and Chief Executive Officer

Ronald J. Poelzer
Vice President and Chief Financial Officer

AUDITORS' REPORT TO THE SHAREHOLDERS

WE have audited the consolidated balance sheets of Bonavista Petroleum Ltd. as at December 31, 1998 and 1997 and the consolidated statements of operations and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Calgary, Canada
March 2, 1999

CONSOLIDATED BALANCE SHEETS

December 31,		1998		1997
ASSETS				
Current assets				
Cash and short-term deposits	$	**20,577**	$	21,233
Accounts receivable		**5,127,200**		3,000,884
Prepaid expenses		**410,628**		232,506
		5,558,405		3,254,623
Oil and natural gas properties and equipment (note 3)		**92,141,927**		45,124,114
	$	**97,700,332**	$	48,378,737
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Accounts payable and accrued liabilities	$	**7,701,064**	$	4,422,082
Long-term debt (note 4)		**33,835,352**		2,990,145
Site restoration provision		**1,990,305**		1,069,859
Deferred income taxes		**868,000**		–
Shareholders' equity				
Share capital (note 5)		**48,749,518**		39,956,629
Retained earnings (deficit)		**4,556,093**		(59,978)
		53,305,611		39,896,651
	$	**97,700,332**	$	48,378,737

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

Michael M. Kanovsky, Director

Harry L. Knutson, Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

Years ended December 31,	1998	1997
REVENUES		
Production	**$ 26,856,681**	$ 13,310,224
Royalties	**(5,062,118)**	(2,320,558)
Alberta Royalty Tax Credit	**1,387,000**	658,858
	23,181,563	11,648,524
EXPENSES		
Operating	**5,145,041**	2,940,260
General and administrative	**660,926**	1,585,413
Financing charges	**1,730,936**	1,370,611
Depreciation, depletion and site restoration	**9,958,000**	5,883,000
	17,494,903	11,779,284
Income (loss) before income and other taxes	**5,686,660**	(130,760)
Income and other taxes (note 6)	**1,070,589**	27,339
NET INCOME (LOSS)	4,616,071	(158,099)
Retained earnings (deficit), beginning of year	**(59,978)**	98,121
RETAINED EARNINGS (DEFICIT), END OF YEAR	$ 4,556,093	$ [illegible]
NET INCOME (LOSS) PER SHARE - BASIC	$ 0.22	$ (0.01)
NET INCOME (LOSS) PER SHARE - FULLY DILUTED	$ 0.20	$ [illegible]

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31,	1998	1997
Cash provided by (used in):		
OPERATING ACTIVITIES		
Net income (loss)	$ **4,616,071**	$ (158,099)
Items not requiring cash from operations:		
Depreciation, depletion and site restoration	**9,958,000**	5,883,000
Deferred income taxes	**868,000**	–
Cash flow from operations	**15,442,071**	5,724,901
Decrease (increase) in non-cash working capital items	**974,544**	(526,172)
	16,416,615	5,198,729
FINANCING ACTIVITIES		
Issuance of share capital, net of share issue costs	**8,792,889**	26,468,616
Increase (decrease) in long-term debt (notes 2 and 4)	**30,845,207**	(2,196,455)
	39,638,096	24,272,161
INVESTING ACTIVITIES		
Loan receivable	**–**	4,920,000
Oil and natural gas properties and equipment additions	**(56,009,563)**	(6,997,504)
Proceeds on sale of oil and natural gas properties	**14,750**	963,479
Site restoration expenditures	**(60,554)**	(108,677)
Acquisition of the assets of Lone Butte Energy Inc. (note 2)	**–**	(28,595,000)
	(56,055,367)	(29,817,702)
Decrease in cash and short-term deposits	**(656)**	(346,812)
Cash and short-term deposits, beginning of year	**21,233**	368,045
CASH AND SHORT-TERM DEPOSITS, END OF YEAR	$ **20,577**	$ 21,233
CASH FLOW FROM OPERATIONS PER SHARE - BASIC	$ **0.72**	$ 0.53
CASH FLOW FROM OPERATIONS PER SHARE - FULLY DILUTED	$ **0.61**	$ 0.49

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 1998 and 1997

1. SIGNIFICANT ACCOUNTING POLICIES

Since a determination of many assets, liabilities, revenues and expenses is dependent upon future events, the preparation of these consolidated financial statements requires the use of estimates and assumptions which have been made using careful judgement. In the opinion of management, these consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

(a) Principles of consolidation

The consolidated financial statements include the accounts of Bonavista Petroleum Ltd. (the "Company") and its wholly owned subsidiaries, Bonavista Energy Ltd. and Bonavista Resources Ltd. By articles of amendment dated January 1, 1999, Bonavista Resources Ltd. was amalgamated with the Company.

(b) Oil and natural gas operations

The Company follows the full cost method of accounting, whereby all costs associated with the exploration for and development of oil and natural gas reserves are capitalized in cost centres on a country-by-country basis. Such costs include land acquisitions, drilling, well equipment and geological and geophysical activities. Gains or losses are not recognized upon disposition of oil and natural gas properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of 20 percent or more.

Costs capitalized in the cost centres, including well equipment, together with estimated future capital costs associated with proven reserves, are depreciated and depleted using the unit-of-production method which is based on gross production and estimated proven oil and natural gas reserves as determined by independent engineers. The cost of significant unproven properties is excluded from the depreciation and depletion base. For purposes of the depreciation and depletion calculations, oil and natural gas reserves are converted to a common unit of measure on the basis of their relative energy content. Facilities are depreciated using the declining balance method over their useful lives, which range from 12 to 15 years. Office equipment is recorded at cost and is depreciated over the useful life of the assets on the declining balance basis at 20 percent.

The provision for future site restoration costs is calculated using the unit-of-production method and is included within the provision for depreciation, depletion and site restoration. Costs are estimated each year by management based upon current regulations, costs, technology and industry standards. Actual costs as incurred are charged against the accumulated liability.

In applying the full cost method, the Company calculates a ceiling test which restricts the capitalized costs less accumulated depreciation and depletion from exceeding an amount equal to the estimated undiscounted value of future net revenues from proven oil and natural gas reserves, based on year end prices and costs, plus the cost, net of impairments, of unproved properties and after deducting estimated future site restoration costs, general and administrative expenses, financing costs and income taxes.

(c) Flow-through shares

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Oil and natural gas properties and share capital are reduced by the estimated benefit to the renounced tax deductions when the expenditures are incurred.

(d) Financial instruments

From time to time, the Company may use swap agreements or other financial instruments to hedge its exposure to fluctuations in oil and natural gas prices. Gains and losses arising from these swap arrangements are reported as adjustments to the related revenue account over the term of the financial instrument. Financial instruments are not used for speculative purposes. The carrying values of the Company's monetary assets and liabilities approximate their fair values.

(e) Deferred income taxes

The Company follows the deferral method of accounting for income taxes.

(f) Comparative figures

Certain of the comparative figures have been reclassified to conform to the current year's presentation.

2. ACQUISITIONS

(a) Assets of Lone Butte Energy Inc.

Effective February 1, 1997, the Company acquired all of the oil and natural gas properties and equipment of Lone Butte Energy Inc. and assumed the associated longterm debt. This acquisition has been accounted for by the purchase method, whereby the oil and natural gas properties and equipment and the associated longterm debt were recorded at fair market values and the operating results have been included in the Company's financial statements from February 1, 1997. The cost of the net assets acquired of $28,595,000 was allocated to oil and natural gas properties and equipment.

Consideration rendered consisted of the following:

Assumption of long-term debt	$ 17,800,000
2,666,667 Common Shares at $1.50 per share	4,000,000
Settlement of loan receivable	4,920,000
Loan payable to Lone Butte Energy Inc.	1,875,000
	$ 28,595,000

The long-term debt assumed in connection with this acquisition was refinanced as part of the consolidation of the Company's bank loan facility (see note 4). The $1,875,000 loan payable accrued interest at an effective rate of 15.43 percent per annum and during 1997 was retired on the issue of $1,875,000 of convertible debentures (see note 4).

(b) Acquisition of Bonavista Resources Ltd.

On November 26, 1997, the Company acquired all of the outstanding shares of 747775 Alberta Ltd. (now Bonavista Resources Ltd.). This acquisition was accounted for by the purchase method. The Company acquired 747775 Alberta Ltd. for consideration of 6,300,000 Common Shares and Special A Warrants and Purchase Obligation Agreements pursuant to which up to 3,150,000 Common Shares of the Company may be issued through a series of transactions over the two years following the acquisition at an average price of $2.00 per Common Share. At closing, the assets of Bonavista Resources Ltd. consisted primarily of approximately $8,900,000 of cash and liquid marketable securities. As at December 31, 1997, the Company has disposed of all of the securities acquired, resulting in no gains or losses.

3. OIL AND NATURAL GAS PROPERTIES AND EQUIPMENT

December 31, 1998	**Cost**	**Accumulated depreciation and depletion**	**Net book value**
Oil and natural gas properties	**$ 81,183,282**	**$ 15,078,726**	**$ 66,104,556**
Facilities and well equipment	**31,592,402**	**5,880,776**	**25,711,626**
Office equipment	**551,452**	**225,707**	**325,745**
	$113,327,136	**$ 21,185,209**	**$ 92,141,927**

December 31, 1997			
Oil and natural gas properties	$ 34,970,555	$ 8,344,726	$ 26,625,829
Facilities and well equipment	22,015,417	3,718,776	18,296,641
Office equipment	346,351	144,707	201,644
	$ 57,332,323	$ 12,208,209	$ 45,124,114

Unproved property costs of $14,283,000 as at December 31, 1998 (1997 - $5,004,000) were excluded from the depreciation and depletion calculation. During the year ended December 31, 1998, a provision of $981,000 (1997 - $541,000) was recorded for site restoration. As at December 31, 1998, the estimated future site restoration costs to be accrued over the remaining proved reserves are $6,669,000 (1997 - $4,998,000). For the year ended December 31, 1998, no general and administrative costs were capitalized (1997 - $114,000) pertaining to the Company's exploration, development and property acquisition programs.

4. LONG-TERM DEBT

(a) Bank loan

The Company has a $61 million revolving demand loan facility, which bears interest at prime and is subject to annual review by the lender. As at December 31, 1998, the outstanding bank loan was $33,835,352 (1997 - $2,990,145). The bank loan facility is secured by a first floating charge debenture, general assignment of book debts and the Company's oil and natural gas properties and equipment. Although the revolving line of credit is payable on demand, the lender has advised that it does not intend to demand repayment of the outstanding principal balance on the credit facility prior to December 31, 1999.

(b) Convertible debentures

During 1997, the Company issued convertible debentures with a principal amount for $3,950,000 of which $1,875,000 was issued in retirement of the loan associated with the acquisition of the assets of Lone Butte Energy Inc. (see note 2). The debentures were converted into 1,000,000 Common Shares and 975,000 special warrants of the Company. Two of the directors of the Company directly or through their associates, acquired $1,225,000 of the convertible debentures. A company in which one director of the Company is a shareholder and director received commissions totalling $145,000 for the placement of the debentures.

(c) Facilities financing arrangement

During 1997, the Company completed a $12 million facility financing arrangement, with a 54 month term and an effective interest rate of 8.05 percent. In December 1997, the Company exercised a right of repurchase and settled the facility financing arrangement for $12 million.

5. SHARE CAPITAL

(a) Authorized

Unlimited number of voting Common Shares and Preferred Shares.

(b) Common Shares Issued and to be Issued

	Special Warrants and Rights Number	Special Warrants and Rights Amount	Common Shares Number	Common Shares Amount	Total Share Capital
Outstanding as at December 31, 1996	1,156,666	$ 2,050,800	6,270,481	$ 12,833,048	$14,883,848
Issued for cash:					
Private placement of special warrants	2,500,000	10,000,000	–	–	10,000,000
Exercise of stock options	–	–	264,665	477,021	477,021
Acquisition of the assets of Lone Butte Energy Inc. (note 2)	–	–	2,666,667	4,000,000	4,000,000
Acquisition of Bonavista Resources Ltd. (note 2)	–	–	6,300,000	8,870,292	8,870,292
Conversion of debentures (note 4)	975,000	1,950,000	1,000,000	2,000,000	3,950,000
Shares redeemed as part of Normal Course Issuer Bid	–	–	(20,000)	(34,370)	(34,370)
Estimated tax cost of renounced expenditures	–	–	–	(1,395,835)	(1,395,835)
Costs associated with shares issued	–	–	–	(794,327)	(794,327)
Conversion of special warrants	(643,333)	(1,003,600)	643,333	1,003,600	–
Outstanding as at December 31, 1997	3,988,333	12,997,200	17,125,146	26,959,429	39,956,629
Conversion of special warrants and rights	(3,988,333)	(12,997,200)	3,988,333	12,997,200	–
Issued for cash:					
Private placement of flow-through shares	–	–	927,700	8,256,530	8,256,530
Exercise of stock options	–	–	417,908	655,352	655,352
Costs associated with shares issued	–	–	–	(118,993)	(118,993)
OUTSTANDING AS AT DECEMBER 31, 1998	**–**	**$ –**	**22,459,087**	**$48,749,518**	**$48,749,518**

(i) Pursuant to a special resolution of the shareholders on January 31, 1997, the shareholders approved a one-for-three Common Share consolidation and, accordingly, the number of Common Shares and per share amounts have been calculated on the basis of the consolidated shares outstanding.

(ii) Pursuant to flow-through share offerings, the Company renounced approximately $3,500,000 of qualifying expenditures effective December 31, 1996, all of which were incurred in 1997.

(c) Options

The Company has established a stock option plan whereby officers, directors, employees and consultants may be granted options to purchase Common Shares. As at December 31, 1998 options have been granted to purchase 2,065,166 Common Shares at prices ranging from $1.35 to $7.50 per share and expiring on various dates until December 31, 2003.

(d) Warrants

In connection with the acquisition of Bonavista Resources Ltd. (see note 2), the Company issued Special A Warrants and Purchase Obligation Agreements pursuant to which up to 3,150,000 Common Shares may be issued through a series of transactions at an average price of $2.00 per share. The Special A Warrants expire on November 26, 1999.

(e) Weighted average shares outstanding

During year ended December 31, 1998, there were 21,434,016 (1997 - 10,762,587) weighted average shares outstanding. On a fully diluted basis, there were 26,171,758 (1997 - 11,873,532) weighted average shares outstanding.

6. INCOME TAXES

The provision for income tax differs from the result of which would have been obtained by applying the combined Federal and Provincial income tax rate to the income (loss) before taxes. This difference results from the following items:

Years ended December 31,	1998	1997
Effective tax rate	**44.6%**	44.6%
Expected tax expense (recovery)	**$ 2,536,000**	$ (58,300)
Non-deductible Crown payments, net of the Alberta Royalty Tax Credit	**1,394,000**	512,300
Resource Allowance	**(2,070,000)**	(638,600)
Benefit of prior year losses	**(992,000)**	–
Unrecognized benefit of losses	**-**	184,600
Capital taxes	**202,589**	27,339
PROVISION FOR INCOME TAXES	**$ 1,070,589**	$ 27,339
The provision for income taxes consists of:		
Current	**$ 202,589**	$ 27,339
Deferred	**868,000**	–
PROVISION FOR INCOME TAXES	**$ 1,070,589**	$ 27,339

As at December 31, 1998 and 1997, the Company had total income tax base in excess of the net book value of oil and natural gas properties.

7. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on or after January 1, 2000, and if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect the Company's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Company, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

THE BONAVISTA TEAM

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Heather Tease
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Chris Turpin
Alex Verge
Mary Zbrodoff

ARTC	Alberta Royalty Tax Credit
bbls	Barrels
bbls/day	Barrels per day
mbbls	Thousand barrels
boe	Barrel of oil equivalent
boe/day	Barrel of oil equivalent per day
mboe	Thousand barrels of oil equivalent
mcf	Thousand cubic feet
mcf/day	Thousand cubic feet per day
mmcf	Million cubic feet
mmcf/day	Million cubic feet per day
bcf	Billion cubic feet
WTI	West Texas Intermediate

Units of natural gas are converted into a barrel of oil equivalent at a ratio of ten thousand cubic feet of natural gas to one barrel of oil.

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